

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
OLD FARM LAKE COMPANY	:	DETERMINATION
for Revision of a Determination or for Refund	:	DTA NO. 807058
of Tax on Gains Derived from Certain Real	:	
Property Transfers under Article 31-B of the	:	
Tax Law.	:	

Petitioner, Old Farm Lake Company, 1075 Central Park Avenue, Scarsdale, New York 10583, filed a petition for revision of a determination or for refund of tax on gains derived from certain real property transfers under Article 31-B of the Tax Law.

A hearing was held before Brian L. Friedman, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on February 6, 1991 at 1:15 P.M., with all briefs to be submitted by March 7, 1991. Petitioner appeared by Winick & Rich, P.C. (Richard I. Bier, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Paul A. Lefebvre, Esq., of counsel).

ISSUE

Whether the Division of Taxation, in computing the total consideration received with respect to petitioner's transfer of certain real property, properly determined that a promissory note which formed a portion of such consideration should be valued at the face amount of the note rather than on an alternative method of valuation which took into account that the promissory note was non-interest bearing and was not secured by a mortgage upon the property subject to the sale.

FINDINGS OF FACT

On January 30, 1991, the representatives for petitioner, Old Farm Lake Company ("OFLC"), and for the Division of Taxation entered into a written stipulation, the contents of which are set forth in Findings of Fact "2" through "9". Paragraph "10" of the stipulation refers

to the documents which were to be submitted into evidence at the hearing. With the exception of OFLC's power of attorney, these were the only documents presented and accepted into evidence. Paragraph "11" of the stipulation reserved the rights of the parties to provide the Administrative Law Judge with legal briefs and oral arguments concerning the issue to be considered herein. The contents of paragraphs "10" and "11" are not, therefore, hereinafter set forth.

OFLC sold certain real property (a portion of a condominium development which included the recreational facilities) located in the Town of New Castle, County of Westchester, State of New York to Old Farm Lake Community Association, Inc. ("OFLCAI") in December 1987 for the sum of \$500,000.00. (Apparently, the condominium units were sold in separate transactions.)

The purchase price consisted of a non-interest-bearing promissory note ("Note") with a face value of \$500,000.00 and a term not to exceed 15 years.

Pursuant to its terms, the Note was to be paid in installments equal to the product of \$300.00 and the number of members in OFLCAI, other than OFLC, existing on such payment date as follows:

- a. the first installment was payable at the closing held in December 1987;
- b. thereafter, annual installments were to be payable on each anniversary date of the Note (December 1, 1987) until the earliest of (i) the date on which the Note was paid in full, or (ii) the date on which the sixteenth installment was paid; and
- c. any unpaid balance remaining after the sixteenth installment would be forgiven.

Payment of all obligations of OFLCAI under the Note were partially guaranteed by Old Farm Lake III Condominium pursuant to a limited guaranty dated December 2, 1987. Old Farm Lake I Condominium and Old Farm Lake II Condominium were also requested to execute guarantees but did not do so.

The Note was unsecured, i.e., it was not secured by a mortgage upon the real property subject to the sale.

In July 1987, OFLC submitted to the New York State Department of Taxation and Finance a Form TP-580, Transferor Questionnaire, and a Form TP-581, Transferee Questionnaire. The transferor questionnaire set forth the consideration to be paid and the anticipated New York State real property transfer gains tax ("gains tax"). On the TP-580 and TP-581, OFLC valued the Note in the amount of \$299,463.53.

OFLC arrived at the figure of \$299,463.53 as the value of the Note by using a computation contained within Internal Revenue Code § 483 regarding imputed interest to ascertain the then present fair market value of the Note. OFLC used a discount rate of 10.45 percent, which is 120 percent of the applicable Federal long-term rate in effect in June 1987. This figure has not been verified by the Division of Taxation. The parties herein agree that, if OFLC prevails in this proceeding, this matter shall be remanded to the Division of Taxation for verification of the payments made pursuant to the terms of the Note and for verification of the computation which OFLC utilized to arrive at the amount of the refund claimed.

On October 14, 1987, the Division of Taxation issued a Tentative Assessment and Return which valued the Note at its face value of \$500,000.00, resulting in an assessment of gains tax in the amount of \$50,000.00.

On December 1, 1987, OFLC filed a Supplemental Return (Form TP-583) along with the Tentative Assessment and Return (see, Finding of Fact "9") prepared by the Division. OFLC paid the sum of \$25,000.00 (50 percent of the tax due) upon closing of the property on December 10, 1987 with the balance to be paid on a deferred basis.

On May 9, 1988, OFLC filed a Claim for Refund of Real Property Transfer Gains Tax (Form TP-165.8). By letter to OFLC dated July 13, 1988, the Division of Taxation denied the claim for refund in its entirety. This letter stated, in pertinent part, as follows:

"The basis of the claim is that in computing your project [sic] tax the department valued the 15 year promissory note that was given in full payment of the purchase price at its face value of \$500,000. The claimant feels we should have used a discounted value of \$299,436.53, which would have resulted in lower tax.

Section 590.12 of the New York State Transfer Gains Tax Regulations provides that in a case where the price paid for the interest in real property is in the form of cash and a purchase money mortgage, the consideration is 'the sum of the cash and

the face amount of the mortgage taken back by the transferor'."

SUMMARY OF PETITIONER'S POSITION

In calculating the fair market value, for tax purposes, of a note received as consideration for a sale, the courts have consistently used the discount value of the note which is determined by considering such factors as maturity date, interest rate, collateral and the financial status of the maker.¹

Petitioner maintains that the Internal Revenue Code (at section 483 thereof) specifically sets forth a method for ascertaining the value of a non-interest-bearing promissory note received as partial payment for a sale of property by providing for the discounting of the face amount of such note.

Petitioner further asserts that the regulation (20 NYCRR 590.12) referred to in the Division's letter denying its refund application specifically refers to a mortgage. In the present matter, the valuation at issue relates not to a mortgage, but to a promissory note not secured by a mortgage.

CONCLUSIONS OF LAW

A. Tax Law § 1441 imposes a tax at the rate of 10 percent upon gains derived from the transfer of real property within the State. The term "gain" is defined in Tax Law § 1440(3) as:

"the difference between the consideration for the transfer of real property and the original purchase price of such property, where the consideration exceeds the original purchase price."

B. Tax Law § 1440(1)(a) defines "consideration" as follows:

"'Consideration' means the price paid or required to be paid for real property or any interest therein.... Consideration includes any price paid or required to be paid, ...including the amount of any mortgage, purchase money mortgage, lien or other encumbrance, whether the underlying indebtedness is assumed or taken subject

¹It must be noted (and petitioner so admits in its memorandum of law) that the cases cited by petitioner do not pertain to the valuation of such notes for purposes of assessing the real property transfer gains tax. Due to the relatively recent enactment of this tax, petitioner states that there are no published opinions on this issue. The cases cited, therefore, relate to valuation for income and estate tax purposes.

to. Consideration includes the cancellation or discharge of an indebtedness or obligation." (Emphasis added.)

20 NYCRR 590.12 provides as follows:

"Question: How is the consideration for the transfer of real property computed where the price paid for the interest is in the form of cash and a purchase money mortgage?

Answer: The consideration paid for the transfer is the sum of the cash and the face amount of the mortgage taken back by the transferor."

C. In contrast, Tax Law § 1440(1)(b) provides as follows:

"In the case of (i) the granting of an option with use and occupancy of real property or (ii) the creation of a leasehold or sublease that is a transfer of real property, as defined in subdivision seven of this section, consideration shall also include the value of the rental and other payments attributable to the use and occupancy of the real property or interest therein and the value of any option to purchase or renew included in such transfer." (Emphasis added.)

With respect to leases, 20 NYCRR 590.26 sets forth the method for the valuation of leases in determining consideration and states, in part, as follows:

"The consideration paid to the lessor includes the present value of the right to receive the rental payments for the term of the lease and the present value of the rental payments attributable to any renewal term." (Emphasis added.)

This regulation also provides for the computation of a discount rate to be used in determining present value.

D. In Matter of Normandy Associates (Tax Appeals Tribunal, March 23, 1989), the Tribunal, in dealing with that petitioner's assertion that a ten-year wraparound note should not have been included in the consideration at its face amount, but should have, instead, been included in consideration at the value thereof, stated as follows:

"We conclude that the Division's position that the face amount of the mortgage, rather than its value, is correct under the law. Tax Law section 1440(1)(a) provides that consideration includes 'the amount of any mortgage, purchase money mortgage, lien or other encumbrance' (emphasis added). In contrast, in the same section of the law the 'consideration' for a lease is defined to include 'the value of the rental...' (emphasis added). Since the Division's interpretation is in accord with, and gives significance to, the different terms used by the Legislature in defining consideration, we agree with the Administrative Law Judge that it is a correct interpretation."

E. OFLC seeks to distinguish the present matter from the Matter of Normandy Associates (supra) and from the wording of Tax Law § 1440(1)(a) on the basis that the

promissory note at issue herein is not a mortgage and, in addition, is unsecured and is, therefore, not a lien or encumbrance on the real property. However, in Matter of Festival Leasehold Co. (Tax Appeals Tribunal, January 20, 1989), the Tribunal sustained a determination that a non-interest-bearing promissory note, secured by the purchaser's letter of credit, should be factored into total consideration at the face amount of the note rather than at a discounted figure.

In the matter at issue, the Note was guaranteed pursuant to a written guaranty from Old Farm Lake III Condominium (see, Finding of Fact "5"). OFLC's attempt to distinguish this matter from the aforementioned Tax Appeals Tribunal decisions is unpersuasive. It is clear from the language of Tax Law § 1440(1) that the Legislature fully intended to distinguish, for purposes of defining "consideration", leases (value) from mortgages (amount). While the Note herein is not a mortgage in the sense that it is secured by the property purchased, it more clearly approaches a mortgage than a leasehold interest since, like a mortgage, it provides for the loaning of funds to enable a transfer of real property to occur. It is, therefore, determined that the Division of Taxation properly included the Note, for purposes of calculating consideration and the resulting gains tax liability, at its face amount of \$500,000.00.

F. The petition of Old Farm Lake Company for refund of real property transfer gains tax is denied.

DATED: Troy, New York
10/10/91

ADMINISTRATIVE LAW JUDGE